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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION THREE

SAVVY PROPERTY MANAGEMENT
et al.,

Plaintiffs and Appellants,

v.

UNITED NATIONAL INSURANCE
COMPANY,

Defendant and Respondent.

B214549

(Los Angeles County
Super. Ct. No. BC400496)

APPEAL from an order of the Superior Court of Los Angeles County, Malcolm H. Mackey, Judge. Affirmed.

Lisitsa Law Corporation and Yevgeniya Lisitsa; Law Office of Sanaz Razi and Sanaz Razi for Plaintiffs and Appellants.

Nixon Peabody, Gregory E. Schopf and Walter T. Johnson for Defendant and Respondent.

INTRODUCTION

After tenants sued David Behrend, Savvy Property Management, LLC, and Melissa Bederman (plaintiffs), among others, alleging uninhabitable conditions in their building, plaintiffs tendered their defense and indemnity to United National Insurance Company (United). United agreed to provide a defense subject to a complete reservation of rights and appointed three separate attorneys to represent each of the three plaintiffs. Plaintiffs and United disagreed about whether a conflict of interest existed requiring the appointment of independent or *Cumis* counsel¹ and so in the context of the instant declaratory relief action, which plaintiffs brought against United, plaintiffs petitioned the trial court for an order compelling arbitration of the amount of *Cumis* counsel fees pursuant to Civil Code section 2860, subdivision (c).² The trial court denied the motion and plaintiffs appeal. (Code Civ. Proc., § 1294, subd. (a).) We hold that the trial court correctly denied the motion to compel arbitration of the amount of *Cumis* counsel fees because at the time plaintiffs filed their petition, there had been no determination that a conflict of interest actually existed to justify the appointment of independent counsel. Accordingly, we affirm the order.

FACTUAL AND PROCEDURAL BACKGROUND

United issued a policy of commercial general liability and property insurance to David Behrend, Trustee of the 201 North Normandie Avenue Trust and Portofino Properties, LLC, effective November 30, 2006 to November 30, 2007, covering a 16-unit apartment building located at 201 North Normandie Avenue in Los Angeles (the policy).

On March 1, 2007, certain tenants of a different building, this one located at 229 West 25th Street in Los Angeles, filed *Enciso et al. v. Savvy Property Management, LLC et al.*, brought a class action lawsuit against plaintiffs and others, who are alleged to be

¹ *San Diego Federal Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358, 364, superceded by Civil Code section 2860, which has partially changed the rule. (*Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal.App.4th 999, 1001, fn. 1.)

² All further statutory references are to the Civil Code, unless otherwise noted.

present or former owners or managers of the West 25th Street building. (Case No. BC367152.) We are informed that the *Enciso* complaint, which is not in the record, alleges uninhabitable conditions of the building at 229 West 25th Street in violation of various state and local health and safety codes and ordinances, which conditions existed as early as 2004.

On March 23, 2007, United issued an endorsement to the policy making the 229 West 25th Street property an insured location, retroactive to March 1, 2007. Then, on June 14, 2007, United issued another endorsement to the policy naming Bederman and Savvy Property as additional insureds under the policy.

The following month, in July 2007, Behrend's personal attorney tendered the *Enciso* lawsuit to United for defense and indemnification on behalf of all defendants. On November 14, 2007, United's counsel notified Behrend's personal attorney that United would provide a defense for Behrend, Savvy Property, and Bederman, subject to a complete reservation of rights including the right to seek reimbursement of defense costs. United believed that certain other *Enciso* defendants were not insureds under the policy, but acceded to Behrend's personal attorney's request to provide a defense for both, subject to the same reservation of rights and only if they agreed to be represented by the same attorney United provided to Behrend, Gary Hoffman, Esq.

Claiming a conflict of interest but without describing it, in July 2008, Bederman and Savvy Property demanded counsel separate from the attorney representing Behrend. United appointed Angelo DuPlantier, Esq. to defend them, subject to the same reservation of rights. Savvy Property then claimed an undefined conflict of interest with Bederman and so United agreed to provide Savvy Property with another attorney, Karl R. Loureiro, Esq., subject to the same reservation of rights. Apparently, Behrend's personal attorney (the Lisitsa Law Corporation), continued to represent Savvy Property and Behrend.

In July 2008, because Behrend's personal attorney raised the issue of payment of independent or *Cumis* counsel fees, United explained that it perceived no conflict of interest and requested further clarification. Nevertheless, to eliminate any concern about

a potential conflict of interest, United agreed to waive the reservation of rights that was premised on the insureds' intentional conduct or knowing violation of the statutes at issue. United maintains its view that it owes no duty to defend and no conflict of interest exists.

Insisting they were entitled to *Cumis* counsel fees, on October 23, 2008, plaintiffs filed the instant lawsuit seeking declaratory relief and damages for breach of contract, bad faith, breach of the implied covenant of good faith and fair dealing.

Then, on December 29, 2008, plaintiffs filed their petition to compel arbitration at issue here (§ 2860, subd. (c)). The petition sought “an order staying the case and compelling *the fee dispute* (as opposed to the Breach of Contract . . . relating to lost rents and other duties under the policy; *except fees*) to binding arbitration.” (Italics added.) In their memorandum, plaintiffs asserted: “The *sole issue* that the Court is being asked *to compel arbitration on* is what is the appropriate *number of hours* that United failed to pay for and what is the appropriate *hourly rate* for that work.” (Italics added.) Plaintiffs' notice did not state they were seeking a determination, and their memorandum of points and authorities did not argue the existence, of either a duty to defend or a conflict requiring the appointment of *Cumis* counsel.

The trial court denied plaintiffs' petition to compel arbitration. It explained, “[b]efore the parties can resolve their fee dispute regarding the independent counsel retained in the underlying actions, they must first resolve the issue of *whether there was*, in fact, a conflict of interest requiring the retention of independent counsel. . . . [T]his issue is for the courts, not the arbitration proceeding” as it is a factual question. (Italics added.) The court rejected appellants' argument that United unequivocally agreed to the appointment of independent counsel because it paid \$150,000 to the Lisitsa Law Corporation. The court stated that the issue whether *Cumis* counsel was appropriate must be decided before the question of whether to compel arbitration of the fee amount can be addressed. Plaintiffs' timely appeal ensued.

CONTENTION

Appellants contend that the trial court erred in failing to “rule one way or another as to whether conditions for invocation of [section] 2860 exist”

DISCUSSION

“An insurance carrier owes a duty to defend its insured whenever a suit against the insured ‘*potentially* seeks damages within the coverage of the policy.’ [Citation.] The duty to defend continues until the insurer can conclusively eliminate, through undisputed facts, any potential for coverage under the policy. [Citation.]” (*Truck Ins. Exchange v. Superior Court* (1996) 51 Cal.App.4th 985, 993.) When there is a question about whether the duty to defend exists, the insurer has three options: (1) accept defense of the lawsuit without raising objection to coverage, thus waiving its right to contest coverage later. (2) Refuse to furnish a defense and potentially risk losing control over the defense and exposing itself to a suit for breach of contract and of the covenant of good faith and fair dealing. (3) Defend the action under a reservation of rights. (*Id.* at pp. 993-994.)

Under the third option, “‘if the insurer adequately reserves its right to assert the noncoverage defense later, it will not be bound by the judgment. If the injured party prevails, that party or the insured will assert his claim against the insurer. At this time the insurer can raise the noncoverage defense previously reserved. In this manner the interests of insured and insurer in defending against the injured party’s primary suit *will be identical*’ [Citation.] If the reservation of rights agreement contains a reimbursement clause, the carrier retains its right to seek reimbursement for payments expended if noncoverage is ultimately proven. [Citations.]” (*Truck Ins. Exchange v. Superior Court, supra*, 51 Cal.App.4th at p. 994, italics added.)

As is pertinent here, *if* this reservation of rights creates a conflict of interest between the insurance company and its insured, the insured has the right to demand independent or *Cumis* counsel. (§ 2860, subd. (a).)³ Where there is a conflict, to

³ Section 2860 reads in relevant part, “If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer

“ “eliminate the ethical dilemmas and temptations that arise along with conflict in joint representations,” ’ the insurer is required to provide its insured with independent counsel of the insured’s choosing ‘who *represents* the insured, not the insurer’; and the insured may thereafter control the defense of the case. [Citations.]” (*Long v. Century Indemnity Co.* (2008) 163 Cal.App.4th 1460, 1469-1470.) If independent counsel is required, the insurer is obligated to pay fees to the independent counsel selected by the insured and “[a]ny dispute concerning attorney’s fees not resolved by [the statute] shall be resolved by final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.” (§ 2860, subd. (c).)

“Various circumstances may create a conflict of interest for defense counsel under applicable statutes and rules of professional conduct.” (Croskey et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 2009) ¶ 7:770, p. 7B-94 (rev. #1, 2009).) One situation creating a conflict of interest that might require appointment of independent counsel is codified in section 2860: “when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest *may* exist.” (§ 2860, subd. (b), italics added.) “*But not every reservation of rights entitles an insured to select Cumis counsel.* There is no such entitlement, for example, where the coverage issue is independent of, or extrinsic to, the issues in the underlying action [citation] or where the damages are only partially covered by the policy. [Citations.]” (*Dynamic Concepts, Inc. v. Truck Ins. Exchange, supra*, 61 Cal.App.4th at p. 1006 (*Dynamic Concepts*));⁴ see also, Croskey et al., *supra*, ¶¶ 7:772 to 7:779, pp. 7B-94.1 to 7B-94.3; *James 3 Corp. v. Truck*

shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing, the right to independent counsel.”

⁴ “Civil Code section 2860, subdivision (b), tells us when a conflict *may* exist, i.e., when there is a reservation of rights and first counsel chosen by the insurer can control the outcome of the coverage issue. It also tells us certain circumstances where a conflict of interest does not exist.” (*United States Fidelity & Guaranty Co. v. Superior Court* (1988) 204 Cal.App.3d 1513, 1525.)

Ins. Exchange (2001) 91 Cal.App.4th 1093, 1108-1109; *Long v. Century Indemnity Co.*, *supra*, 163 Cal.App.4th at p. 1470.) Whether a conflict of interest arises after the carrier reserves its rights depends on the nature of the coverage issue as it relates to the issues in the underlying lawsuit. (*Blanchard v. State Farm Fire & Casualty Co.* (1991) 2 Cal.App.4th 345, 350.)

Therefore, the parties may genuinely disagree about whether a conflict exists. (*Royal Surplus Lines Ins. Co., Inc. v. Ranger Ins. Co.* (2002) 100 Cal.App.4th 193, 202 [“It is not obvious from the face of the complaint whether there is a conflict in this case.”]; see also *Dynamic Concepts*, *supra*, 61 Cal.App.4th at p. 1010 [carrier may conduct investigation to determine conflict before it agrees to appointment of *Cumis* counsel].) Where there is a disagreement, determination of the existence of a conflict of interest requiring appointment of independent counsel is a factual question subject to judicial resolution as a foundational matter. (*Compulink Management Center, Inc. v. St. Paul Fire & Marine Ins. Co.* (2008) 169 Cal.App.4th 289, 300, quoting from *Handy v. First Interstate Bank* (1993) 13 Cal.App.4th 917, 924-926.) The “potential for conflict requires a *careful analysis* of the parties’ respective interests to determine whether they can be reconciled (such as by a defense based on total nonliability) or whether an actual conflict of interest precludes insurer-appointed defense counsel from presenting a [good] quality defense for the insured.” (*Dynamic Concepts*, *supra*, at pp. 1007-1008, italics added.)

Plaintiffs here appear to contend that as soon as United reserved its rights a conflict was created justifying plaintiffs’ use of *Cumis* counsel, with the result the trial court erred in failing to grant the motion to compel arbitration of the amount of independent counsel’s fees. But, as noted, a reservation of rights alone is not sufficient to entitle an insured to select *Cumis* counsel. (*Dynamic Concepts*, *supra*, 61 Cal.App.4th at p. 1006.) Indeed, the court in *Dynamic Concepts* rejected a “per se rule requiring the appointment of an independent counsel whenever a carrier issues a so-called ‘global reservation of rights’.” (*Id.* at p. 1007.) Likewise, that court rejected a per se rule requiring appointment of *Cumis* counsel whenever the insurer “reserves its right to seek

reimbursement for defense costs for uncovered claims” pursuant to *Buss v. Superior Court* (1997) 16 Cal.4th 35. (*Dynamic Concepts, supra*, at p. 1007; accord, *Royal Surplus Lines Ins. Co. v. Ranger Ins. Co., supra*, 100 Cal.App.4th at pp. 201-202.)

Plaintiffs next argue that it is impractical to require the trial court to resolve the issue of *appointment* of *Cumis* counsel first, and that the issue should be determined in connection with the petition to compel arbitration of the *amount* of independent counsel fees under section 2860, subdivision (c). However, plaintiffs’ petition to compel arbitration put no facts before the trial court to support a finding that a conflict existed, with the result they precluded that court from making such a determination.

Moreover, since 1988, the year section 2860 took effect, it has been the law in California that “a declaratory relief action is an appropriate procedure for determining the application of the *Cumis* principles in a given case.” (*United States Fidelity & Guaranty Co. v. Superior Court, supra*, 204 Cal.App.3d at pp. 1524, 1526; *Handy v. First Interstate Bank, supra*, 13 Cal.App.4th at p. 924.) The trial court rather than an arbitrator makes the determination whether a conflict of interest exists requiring appointment of *Cumis* counsel. (See, *Truck Ins. Exchange v. Dynamic Concepts, Inc.* (1992) 9 Cal.App.4th 1147, 1150-1151; *Handy v. First Interstate Bank, supra*, at p. 925, fn. omitted [“in the absence of a stipulation or unconditional agreement between the insurer and insured, unless and until there has been a judicial determination of an insurer’s duty to defend and the existence of a conflict of interest, the provisions of Civil Code section 2860 are inapplicable.”].) “[N]owhere in that subdivision [section 2860, subdivision (c)] -- or anywhere else in the statute, for that matter -- is there the suggestion that a dispute between insurer and insured concerning the duty to provide independent counsel in the first instance is to be resolved” by arbitration. (*Truck Ins. Exchange v. Dynamic Concepts, Inc., supra*, at p. 1150.) *Handy* elaborated why it would be inappropriate to leave this determination to the arbitrator: “the arbitrator would have to interpret the respective policy provisions to determine whether the coverage they afforded imposed a duty to pay ongoing defense costs The effect of such a determination, of course, is a determination of the insurers’ actual duties of defense. As stated, this issue is not

properly submitted to an arbitrator for resolution but must be conclusively established in a judicial proceeding, if necessary, before any subsequent fee dispute may properly be referred to arbitration under Civil Code section 2860.” (*Handy v. First Interstate Bank, supra*, at p. 926.) Thus, plaintiffs are wrong that no appellate court has addressed the issue of whether an arbitrator could decide whether a conflict of interest exists. It has long been the law that the trial court is the appropriate body to resolve this question. (*United States Fidelity & Guaranty Co. v. Superior Court, supra*, 204 Cal.App.3d at pp. 1524, 1526; *Truck Ins. Exchange v. Dynamic Concepts, Inc., supra*, at pp. 1150-1151; *Handy v. First Interstate Bank, supra*, at p. 924.)

Plaintiffs suggest that this procedure -- judicial determination of the need for *Cumis* counsel prior to arbitration of that attorney’s fees -- delays the appointment of independent counsel. We observe that the instant declaratory relief action has already been filed; it was plaintiffs who chose to put the question of arbitrating fee amounts before they had established the foundational issue of whether independent counsel was appropriate. Thus, plaintiffs delayed the final decision. In any event, plaintiffs’ concern about efficiency is dispelled where “the insurer’s duty can often be promptly adduced through summary judgment or full trial of the declaratory relief action with its *statutory calendar preference*. (See Code Civ. Proc., [§] 1062.3.)” (*United States Fidelity & Guaranty Co. v. Superior Court, supra*, 204 Cal.App.3d at p. 1526, italics added.)

Finally, plaintiffs argue that United admitted the existence of a conflict of interest by paying attorney fees in August 2008. However, there is no evidence that United’s August 2008 check was for independent counsel fees rather than regular fees incurred before United accepted the defense and provided counsel upon its reservation of rights.

Moreover, the record is replete with both unequivocal statements by United’s attorneys that the carrier perceived *no* conflict and repeated requests for information on which plaintiffs based their claims of conflict. The carrier was entitled to a reasonable period to conduct an investigation to establish the existence of a conflict before appointing *Cumis* counsel. (*Dynamic Concepts, supra*, 61 Cal.App.4th at p. 1010.) Yet, the record before us is devoid of evidence showing the basis for plaintiffs’ conflict

assertion. We see no reason why plaintiffs, who face the prospect of no defense or indemnity for uncovered claims, may sandbag insurers by demanding *Cumis* counsel based on unspecified and undefined conflict. A mere possibility of a conflict does not require independent counsel. The conflict must be significant, not merely theoretical, actual, not merely potential. (*Id.* at p. 1007.) “A carrier is subject to tort liability for bad faith only where it unreasonably fails to provide benefits due under the policy or the law. [Citations.]” (*Id.* at p. 1010.)

In sum, before a dispute about the amount of fees payable to *Cumis* counsel may be arbitrated, either the parties must unequivocally agree that independent counsel is necessary, or the trial court must make a determination that the insurer owes a duty to defend and a conflict of interest exists between the carrier and insured. (*Handy v. First Interstate Bank, supra*, 13 Cal.App.4th at p. 925; *Truck Ins. Exchange v. Dynamic Concepts, Inc., supra*, 9 Cal.App.4th at pp. 1150-1151.) In this case, United has always maintained it owes no defense and disputes the existence of a conflict of interest. Plaintiffs’ petition to compel arbitration was specifically premised on one issue only, namely, the *amount* of *Cumis* counsel fees. Plaintiffs contend that the trial court erred in failing to determine whether section 2860 was applicable. But, they never put the predicate issue of whether a conflict of interest exists before the trial court in the declaratory relief action. Therefore, the trial court properly ruled that section 2860 was inapplicable and correctly denied plaintiffs’ petition to compel arbitration under subdivision (c) of that section.⁵ Stated otherwise, the court did rule; it ruled that arbitration under section 2860, subdivision (c) was premature.

⁵ *Compulink Management Center, Inc. v. St. Paul Fire & Marine Ins. Co., supra*, 169 Cal.App.4th 289, does not aid plaintiffs here. There, the insurer believed its reservation of rights did create a conflict of interest with Compulink and so the carrier “agreed to allow Compulink to select independent counsel to defend it in the third party suit.” (*Id.* at p. 293.) As noted, there are two scenarios in which *Cumis* counsel is required: (1) where there is “agreement between the insured and the carrier” or (2) a judicial determination had been made that the insurer has both a duty to defend and the a conflict of interest exists. (*Handy v. First Interstate Bank, supra*, 13 Cal.App.4th at p. 925; *Truck Ins. Exchange v. Dynamic Concepts, Inc., supra*, 9 Cal.App.4th at

Finally, we are aware that after this appeal was filed, the trial court granted United's motion for summary adjudication determining, where plaintiffs did not raise a dispute of fact, that as a matter of law, no conflict of interest exists. We asked the parties to brief whether this ruling, made after the ruling appealed from, rendered this appeal moot. We conclude the summary adjudication does not render this appeal moot: the summary adjudication is not final. Plaintiffs certainly may seek arbitration of *Cumis* counsel fees in the future if the summary adjudication were reversed on appeal, and a subsequent final ruling were entered finding that independent counsel were necessary. We specifically decline to address any aspect of the summary adjudication as it is not at issue in this appeal. And, we specifically decline to address whether there exists a conflict of interest as that issue was not put before us in this appeal.⁶

pp. 1150-1151; *Truck Ins. Exchange v. Superior Court*, *supra*, 51 Cal.App.4th at p. 997.) The first situation applied in *Compulink* whereas the second applies here.

⁶ At their request, we granted permission for the parties to file letter briefs addressing the impact on this case of *Intergulf Development LLC v. Superior Court* (2010) 183 Cal.App.4th 16, which was decided while this case was on appeal. We have reviewed Savvy Property's letter brief and reply letter brief and United's response. We conclude that *Intergulf* is in complete accord with our opinion in this case. The issue in *Intergulf* was whether the insurer was entitled to arbitration of an alleged *Cumis* fee dispute under section 2860, subdivision (c) in a bad faith and breach of contract action brought by the insured against the insurer "*where there has been no determination that the insurer had a duty to defend and the parties dispute whether the insurer satisfied that duty and its obligations under Civil Code section 2860. [Citations.]*" (*Intergulf*, *supra*, at p. 18, italics added.) *Intergulf* held that the trial court abused its discretion in granting the insurer's petition to compel arbitration under section 2860, subdivision (c) before it had determined whether there was a duty to defend. (*Intergulf*, *supra*, at p. 18.) The *Intergulf* court thus agrees with this court that the duty to defend and disputes over if and when the insurer recognizes the insured's right to select independent counsel must be resolved *before* there can be arbitration of the *amount* to be paid independent or *Cumis* counsel. (*Id.* at p. 21.) In its letter briefs, Savvy Property argues that the trial court should have determined all of the predicate issues, such as whether *Cumis* counsel was required, when it ruled on Savvy Property's motion to compel arbitration of the fee amount. As explained in detail above, we disagree. First, that predicate issue is moot because the trial court has since determined that no conflict exists to justify Savvy Property's retention of *Cumis* counsel. Second, the petition to compel arbitration is not the proper vehicle for

DISPOSITION

The order appealed from is affirmed. Appellant shall bear costs on appeal.

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ALDRICH, J.

We concur:

KLEIN, P. J.

KITCHING, J.

determining the substantive legal issues in the lawsuit. (*Handy v. First Interstate Bank, supra*, 13 Cal.App.4th at p. 925; *Truck Ins. Exchange v. Dynamic Concepts, Inc., supra*, 9 Cal.App.4th at pp. 1150-1151.) Third, Savvy Property's motion to compel arbitration did not present any issue to the trial court other than the *amount* of fees.